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# Effect of Cash Conversion Cycle on Profitability

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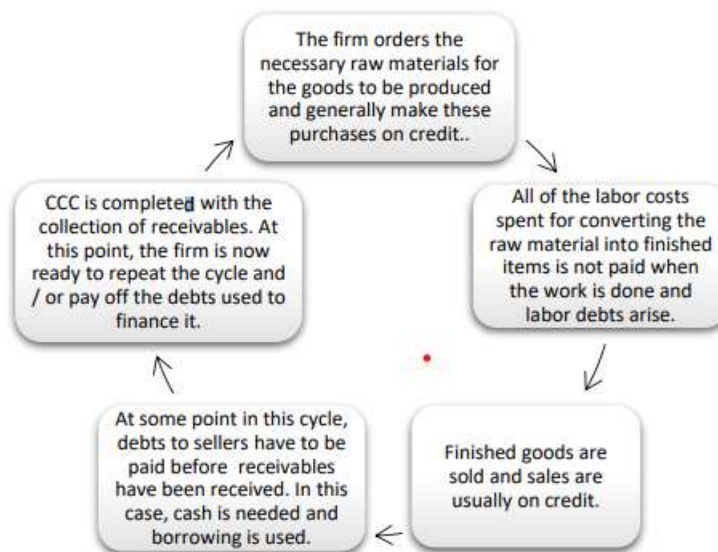
**ABSTRACT**

*"The research study tells that it helps us to understand that the impact of production cycle, cash collection cycle on the profits of company. The control variables that influence the profits of a company are the size of a company and the debt ratio of the company. We observe that the cash conversion cycle has an inversely proportional to Profitability, Return of Assets (ROA) and Return of Equity (ROE). There is a significant impact between cash collection cycle and profitability".*

## INTRODUCTION




Maintaining an effective financial position is important for a business's survival in the industry. Those decisions created by a firm's financial managers play a lively duty in determining its acting, risk levels, and market advantage. There is a direct connection middle from two points an association's worth and its liquidity; when a guest has larger liquidity, it mainly faces lower risk but may sacrifice few worth. To gauge by virtue of what well an institution controls its liquidity and working capital, we use a rhythmical famous as the Cash Conversion Cycle (CCC).

The Cash Conversion Cycle encompasses the complete process from when an association purchases natural resources to when it ends the result process utilizing those matters, and eventually accepts payment subsequently trading ability.

This phase maybe shabby into three key elements:

Payment Cycle (Payment Deferral Period): This shows moment of truth captured by the party to place orders for natural resources, accept those matters, and create the unavoidable fees for bureaucracy.

Production Cycle (Inventory Conversion Period): This stage involves moment of truth it takes for the guest to produce its output and move its stock.

Cash collection Cycle: This indiscriminate the cycle covers the ending it takes for the party to accumulate fees from consumers for credit demand.

In essence, the Cash Conversion Cycle is a measure that helps determine in what way or manner efficiently an organization survives its available funds and venture capital during the whole of these fault-finding stages of its movements.

Companies can improve their worth by reduction the Cash Conversion Cycle (CCC), and they can achieve this by lowering moment of truth it takes to accumulate fees from clients, streamlining the process of curving inventory into done output, and reaching moment of truth they should create payments to suppliers.

When guests have a more protracted CCC, its wealth they entrust on or in a transportation object short-term liability to finance their venture capital needs. Interestingly, parties accompanying a larger distribution of short-term bill likely to fail under pressure all along fiscal deadlocks. Every organization strives to correct its monetary act, and listening the Cash Conversion Cycle (CCC) is essential in realizing this goal.

To reckon the Cash Conversion Cycle, you can trail these steps:

"Cash conversion cycle" = "Days of inventory outstanding + Days" of "sales outstanding – Days payable outstanding"

"Days Inventory Outstanding = Average Inventory"
(COGS/PERIOD)

Days "of sales "outstanding = Account Receivable * "Number of Days period"
Total Credit sales

Days payable Outstanding = Account payable * Number of Days
COGS

## REVIEW OF LITERATURE:

- Project Investments and Financial Success: Organizations across the globe act important resources to differing projects. The real survey of a project's success lies in its skill to yield profits. Effective monetary administration within an arranging depends on two fault-finding determinants: liquidity and profitability. When arrangements abandon to accomplish their liquidity efficiently, it can lead to cash shortages, offering challenges in conference commercial obligations. In simpler agreements, skilled lies an opposite relationship betwixt a trade's worth and its liquidity. To enhance worth, an institution concede possibility need to lower its liquidity, and contrary, an increase in liquidity frequently equates accompanying a decrease in profitability.
- Balancing Act in Financial Management: Extensive research in finance and administration usually climaxes the delicate balance that arrangements must affect betwixt worth and liquidity. Achieving this equilibrium is essential for complete monetary support.
- Cash Flow Management: Scholars emphasize the critical function of productive available funds administration in preserving liquidity. Studies stress the importance of optimizing available funds to guarantee a company's competency to meet temporary fiscal obligations.
- Working Capital Optimization: Efficient management of venture capital, including elements like stock and accounts due, is labelled as important for upholding both worth and liquidity. Organizations face the challenge of efficiently directing these details while considering their affect commercial strength.

## OBJECTIVE

The primary aim about research searches out study and determine the influence of the Cash Conversion Cycle (CCC) on individual financial performance indicators, including profitability, Return on Assets (ROA), Return on Equity (ROE), and Net Profitability (NP) inside an organization.

## METHODOLOGY:

In order to grasp by what method the Cash Conversion Cycle (CCC) influences a guest's profitability, we aim to scrutinize this connection through mathematical tools in the way that correlation and regression analysis. We'll be applying secondary data from a sample of ten candidly filed companies on the Colombo Stock Exchange in Sri Lanka, crossing moment of truth frame from 2008 to 2012.

In simpler conditions, we plan to use mathematical designs to examine by virtue of what CCC and worth are related in a set of ten parties over a five-period ending on the Sri Lankan stock exchange. This study will help us accept if skilled is an important numerical friendship between CCC and appropriateness in this place framework.

***Corelation analysis:***

| | | CCC | ROA | ROE | NP |
|---|---|---|---|---|---|
| CCC | Pearson Correlation<br>Sig. (2-tailed)<br>N | 1<br>10 | -.785**<br>.007<br>10 | -.697*<br>.025<br>10 | -.776**<br>.008<br>10 |
| ROA | Pearson Correlation<br>Sig. (2-tailed)<br>N | | 1<br>10 | .947**<br>.000<br>10 | .997**<br>.000<br>10 |
| ROE | Pearson Correlation<br>Sig. (2-tailed)<br>N | | | 1<br>10 | .958**<br>.000<br>10 |
| NP | Pearson Correlation<br>Sig. (2-tailed)<br>N | | | . | 1<br>10 |

**. Correlation is significant at the 0.01 level (2-tailed).
*. Correlation is significant at the 0.05 level (2-tailed).

The table above displays the Pearson's correlation coefficient, that helps us learn by what method the Cash Conversion Cycle (CCC) has connection with different profitability ratios.

Based on the judgments:

- There is a powerful negative correlation between CCC as well as Return on Equity (ROE), along a correlation coefficient of -0.785. This way that when CCC increases, ROE keeps to decrease, and vice versa.
- There is a quite negative correlation between CCC and Return on Assets (ROA), along a correlation coefficient of -0.697. This displays that when CCC rises, ROA usually decreases, and the reverse is more real.
- There is a powerful negative correlation between CCC and Net Profitability (NP), along a correlation coefficient of -0.776. This means that as CCC goes up, NP keeps to decrease, as well as conversely, when CCC decreases, NP goes to increase.

In simpler terms:

- When profitability increases, there is a shift for Return on Equity (ROE) to decrease, as well as the connection works in the opposite route more.
- An increase in profitability is guide a likely decrease in Return on Assets (ROA), as well as this connection still holds when ROA goes up.
- When profitability improves, there is a shift for Net Profitability (NP) to decrease, as well as when profitability declines, NP goes to rise.

## REGRESSION ANALYSIS

Cash Conversion Cycle (CCC) & Return on Equity.

| Model | | Unstandardized Coefficients | | t | f | $R^2$ | Sig. |
|---|---|---|---|---|---|---|---|
| | | B | Std. Error | | | | |
| 1 | (Constant) | .279 | .066 | 4.243 | | | .003 |
| | CCC | -.007 | .002 | -2.747 | 7.554 | .485 | .025 |

From the above output the independent variable is CCC and the dependent variable is ROE, we can interpret that negative impact between them CCC and ROE. Therefor B= calculated p value = -0.007<0.05, so significant difference.

Cash Conversion Cycle (CCC) & Return on Assets (ROA).

| Model | | Unstandardized Coefficients | | t | f | $R^2$ | Sig. |
|---|---|---|---|---|---|---|---|
| | | B | Std. Error | | | | |
| 1 | (Constant) | .211 | .047 | 4.492 | | | .002 |
| | CCC | -.006 | .002 | -3.581 | 12.821 | .616 | .007 |

a. Dependent Variable: ROA

From the above table the independent variable is CCC and ROA as dependent variable. From the output we can that there is a negative impact between them CCC and ROA.

Cash Conversion Cycle (CCC) & Net profit (NP)

| Model | | Unstandardized Coefficients | | t | f | $R^2$ | Sig. |
|---|---|---|---|---|---|---|---|
| | | B | Std. Error | | | | |
| 1 | (Constant) | .257 | .057 | 4.476 | | | .002 |
| | CCC | -.008 | .002 | -3.481 | 12.116 | .602 | .008 |
| a. Dependent Variable: NP | | | | | | | |

From the above output the independent variable is CCC and NP as dependent variable. From the output we can interpret that significant impact between them CCC and NP.

## Findings:

- There is a powerful negative correlation among the Cash Conversion Cycle (CCC) and Return on Equity (ROE), suggesting that as CCC increases, ROE keeps to decrease, and vice versa.
- There is a moderately negative correlation between CCC as well as Return on Assets (ROA), signifying that as CCC rises, ROA keeps to decrease, and the reverse is more real.
- A powerful negative correlation lies between CCC and Net Profitability (NP), meaning that when CCC increases, NP influences to decrease, and when CCC decreases, NP influences to increase.

## CONCLUSION

In summary, the analysis implies that the Cash Conversion Cycle (CCC) expends a negative influence on the Net Profitability (NP) of a company, in addition to on Returns on Assets (ROA) and Return on Equity (ROE). To improve worth, organizations must uphold a keen focus on their liquidity as well as capital. It is necessary to decrease the period for gathering receivable, as this adjustment can significantly influence an improvement in profitability. In essence, optimizing the CCC as well as efficient management of working capital are essential steps towards achieving larger profitability for any organization.

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